

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Dutra Analyst: Marion Mann DeJong Bill Number: AB 2288
Related Bills: _____ Telephone: 845-6979 Amended Date: April 24, 2000
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Statewide Residential Property Tax Offset Credit

SUMMARY OF BILL

This bill would modify current law regarding changes in ownership of real property for purposes of the ad valorem property tax, which would result in an increase of property tax revenues. Also, this bill would reduce the state sales and use tax rate by .25%, which would result in a decrease of sales and use tax revenues. Any net revenue increase from the difference between this property tax revenue increase and this sale and use tax revenue decrease would be used to fund a new income tax credit.

Under the Personal Income Tax (PIT) Law, this bill would create a credit for taxpayers who own a principal residence with a fair market value (FMV) not in excess of 150% of the median sales price of a home in the county in which the residence is located. The amount of the credit would be determined annually by dividing the net revenue increase (discussed above) by the number of qualified taxpayers for the year.

Although a brief discussion of the property tax and sales and use tax provisions of the bill is provided under Specific Findings, this analysis primarily addresses the income tax credit provision of the bill and its impact on the department.

SUMMARY OF AMENDMENT

The April 24, 2000, amendments added the provisions that would increase revenue from the ad valorem property tax, reduce revenue from the sales and use tax, and create a residential property tax offset credit.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment, and the income tax credit would apply to taxable years beginning on or after January 1, 2000.

SPECIFIC FINDINGS

The California Constitution generally limits the ad valorem tax on real property to 1% of the full cash value of that property. The "full cash value" is the assessor's valuation shown on the 1975-76 tax bill or the appraised value of the real property when purchased, newly constructed, or a change in ownership has occurred.

Board Position:

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Department Director

Date

Gerald H. Goldberg

5/11/00

Current state law specifies the circumstances when the transfer of ownership interest in a corporation, partnership, limited liability company, or other legal entity results in a change of ownership of real property. Generally, a change in real property ownership occurs when a legal entity or other person obtains a controlling or majority ownership interest in the legal entity.

This bill would modify what constitutes a change in ownership of real property occurs, allowing an increase in the "full cash value." This would result in an increase in property tax revenues.

The California Constitution and current state law impose a sales or use tax on transfers of tangible personal property. The sales or use tax payable in connection with any given transaction is the sum of three components: (1) the basic state sales and use tax, (2) the Bradley-Burns local tax, and (3) additional local transactions and use taxes, if any. The basic state sales and use tax rate is 6%.

This bill would reduce the basic state sales and use tax rate by .25%.

Current federal and state income tax laws allow taxpayers to deduct certain state and local taxes paid during the taxable year, including real property taxes and personal property taxes. State and local sales and use taxes are deductible if incurred in carrying on a trade or business.

Current federal and state income tax laws provide various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child and dependent care credits) or to influence business practices and decisions or achieve social goals. Credits generally are based on a percentage of expenditures by the taxpayer.

Under the PITL, this bill would create an income tax credit for taxpayers who own a principal residence with an FMV not in excess of 150% of the median sales price of a home in the county in which the residence is located.

The amount of the credit would equal the taxpayer's share of the "statewide residential property tax offset amount" for the taxable year. The "statewide residential property tax offset amount" would mean the difference between the additional ad valorem property tax revenue resulting from the changes made by this bill and the amount of foregone state sales and use tax revenue that is attributable to the .25% rate reduction. The Department of Finance (DOF) would be responsible for determining these amounts and providing them to the Franchise Tax Board (FTB) by December 1 of each year. The taxpayer's share of the "statewide residential property tax offset amount" would be determined by dividing the offset amount by the number of taxpayers claiming the credit.

The county assessor would determine whether the FMV of a residence is less than 150% of the median sales price of a home in that county. Two copies of a written notice of that determination would be provided to the taxpayer with the annual property tax bill. Taxpayers would be required to attach this notification to their income tax return or the credit would be disallowed.

Any credit amount in excess of tax could be carried forward indefinitely.

Policy Considerations

This bill does not specify that the home must be owner occupied. Thus, a credit could be allowed for taxpayers that own a home and rent it to someone else as their principal residence. Further, if the taxpayer owns more than one residence that is used by someone as a principal residence, the credit could be allowed for each residence.

Implementation Considerations

This bill would raise the following implementation concerns. Department staff will work with the author to resolve these concerns as the bill moves through the Legislature.

- The operative dates within the bill are inconsistent. Since the bill is a tax levy it would become effective immediately upon enactment. The property tax provision would become operative on the effective date. The sales and use tax provision specifies it would become operative after December 31, 2000. The income tax provision specifies that it would become operative for taxable years beginning on or after January 1, 2000. Since the credit amount is dependent upon the property tax and sales and use tax provisions, it does not appear that the "statewide residential property tax offset amount" could be determined for 2000. In addition, since DOF must provide the total by December 1, the entire year could not be reflected for 2000.

Further, it is unclear whether the county assessors could determine if a residence was qualified for 2000 in time for the notices to be included with the property tax bills. Property tax bills are normally issued in October with the first installment due November 1.

- The amount of the credit would be determined by dividing the offset amount by the number of "qualified taxpayers claiming the credit." Thus, the amount of the credit could not be determined until after all taxpayers file their tax returns and claim the credit for the taxable year. Taxpayers would not know the amount of their credit when their return is filed.

The bill requires DOF to provide the total offset amount to FTB and requires county assessors both to determine if the residence is qualified and to so notify the property owner. It does not specify who is responsible for determining the actual credit amount.

- The owner of the qualified residence is a qualified taxpayer for this credit. However, there is no correlation between qualified taxpayers and those individuals who have a Personal Income Tax (PIT) liability or filing requirement. It is unclear whether the author intended the credit to be divided only among homeowners with a PIT liability.

If the credit is divided among all homeowners, even those without a tax liability, it is unclear how to account for any unused amounts.

- It may be necessary to have the department issue refunds to qualified taxpayers separate from the tax return process. For example, after the DOF determines the total offset amount and after county assessors determine if a residence is qualified, the offset amount and list of qualified taxpayers could be provided to the department. The department could then determine the amount of refund per qualified taxpayer and issue refunds. Since the credit is not refundable, taxpayers would receive refunds only to the extent of their tax liability, with unused credits carried over to future years.

If this is the process the author uses, the county assessors should also be required to provide a list (on magnetic media) of qualified taxpayers to FTB annually.

- This bill would require the department to disallow any credit claimed if the taxpayer fails to attach the assessor's notice to the tax return. It would be more appropriate to disallow the credit if the taxpayer fails to provide the assessor's notice upon request. This would prevent the disallowance of credits if the taxpayer accidentally omitted the document.
- This bill provides for an income tax credit equal to the amount (offset amount) that the property tax revenue increase exceeds the sales tax revenue reduction. It is unclear what happens if the offset amount is zero or a negative number (i.e., the sales tax revenue reduction is equal to or greater than the property tax revenue increase). For years in which the offset amount is small, the costs to administer the credit could exceed the benefit provided to taxpayers.

FISCAL IMPACT

Departmental Costs

If the implementation concerns are resolved, this bill would not significantly impact the department's costs.

Tax Revenue Estimate

The Board of Equalization (BOE) projects that the amount of state sales and use tax revenues attributed to a state sales and use tax rate reduction of .25% is approximately \$1.1 billion. Neither BOE nor DOF has a current estimate of the total amount of additional ad valorem property tax revenue proposed by this bill. However, based on estimates made in prior years, the BOE believes this amount may be between \$1 billion to \$2 billion. The BOE also estimates that there are 4 million qualified taxpayers.

Because of the uncertainty of the amount of additional ad valorem property tax revenue, the amount of any potential credit is unknown and cannot be determined until the BOE or DOF completes its estimate.

BOARD POSITION

Pending.